

CITY OF BATTLE CREEK, MICHIGAN
POLICE AND FIRE RETIREMENT SYSTEM

Year Ended
June 30, 2013

Financial
Statements and
Supplementary
Information

CITY OF BATTLE CREEK, MICHIGAN

POLICE AND FIRE RETIREMENT SYSTEM

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INDEPENDENT AUDITORS' REPORT

December 23, 2013

To the Retirement Board
City of Battle Creek, Michigan
Police and Fire Retirement System
Battle Creek, Michigan

Report on the Financial Statements

We have audited the accompanying statement of plan net position of the *City of Battle Creek, Michigan Police and Fire Retirement System* (the "System") as of and for the year ended June 30, 2013, and the related statement of changes in plan net position and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Independent Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit program.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the plan net position of the City of Battle Creek, Michigan Police and Fire Retirement System, as of June 30, 2013, and the related statement of changes in plan net position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the schedules of funding progress and employer contributions listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Rehmann Lobson LLC

BASIC FINANCIAL STATEMENTS

CITY OF BATTLE CREEK, MICHIGAN

POLICE AND FIRE RETIREMENT SYSTEM

Statement of Plan Net Position

June 30, 2013

Assets

Cash and cash equivalents	\$ 6,859,685
Investments:	
U.S. treasuries	16,106,741
U.S. agencies	10,075,669
Domestic corporate securities	27,104,414
Domestic equities	23,350,396
American depository receipts	11,667,042
International equities	25,253,035
Real estate trusts	238,831
Total investments	<u>113,796,128</u>
Interest receivable	371,172
Pension contributions receivable	<u>82,389</u>
Total assets	<u><u>121,109,374</u></u>

Liabilities

Due to other governments	512,795
Obligation for impaired investment of securities lending collateral	<u>156,332</u>
Total liabilities	<u><u>669,127</u></u>
Net position held in trust for pension benefits	<u><u>\$ 120,440,247</u></u>

The accompanying notes are an integral part of these financial statements.

CITY OF BATTLE CREEK, MICHIGAN

POLICE AND FIRE RETIREMENT SYSTEM

Statement of Changes in Plan Net Position

For the Year Ended June 30, 2013

Additions

Investment income:

From investing activities:

Net appreciation in fair value of investments	\$ 9,026,540
Interest and dividends	2,485,499
Less investment expenses	(479,884)
Net income from investing activities	<u>11,032,155</u>

From securities lending activities:

Gross earnings	14,688
Borrower rebates	7,063
Securities lending fees	(6,516)
Net gain from securities lending activities	<u>15,235</u>

Total net investment income	<u>11,047,390</u>
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Contributions:

Employer	4,105,429
Employees	955,842
Total contributions	<u>5,061,271</u>

Total additions	<u>16,108,661</u>
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Deductions

Pension benefit payments	7,740,518
Medical insurance premiums	512,795
Contribution refunds	71,686
Administrative expenses	142,729

Total deductions	<u>8,467,728</u>
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Net change to net position held in trust for benefits	7,640,933
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Net position held in trust for benefits, beginning of year	<u>112,799,314</u>
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Net position held in trust for benefits, end of year	<u><u>\$ 120,440,247</u></u>
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The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

CITY OF BATTLE CREEK, MICHIGAN

POLICE AND FIRE RETIREMENT SYSTEM

Notes to Financial Statements

1. PLAN DESCRIPTION

The City of Battle Creek, Michigan Police and Fire Retirement System (the "System") is a single-employer defined benefit contributory pension plan which provides retirement, disability, death and postemployment healthcare benefits to plan members and their beneficiaries in accordance with the City of Battle Creek's (the "City") pension ordinance. The System covers all police and fire employees of the City of Battle Creek.

System membership consisted of the following at June 30, 2012, the date of the latest actuarial valuation:

Retirees and beneficiaries currently receiving benefits	233
Terminated employees entitled to but not yet receiving benefits	7
Vested and non-vested active participants	<u>184</u>
Total	<u><u>424</u></u>

Plan members are required to contribute between 7.5% and 10.0% of their annual covered salary to the System for pension benefits, depending on bargaining unit. The City contributes such additional amounts as necessary, based on actuarial determinations, to provide assets sufficient to pay for member benefits. The City's pension contribution for the year ended June 30, 2013 represented 30.12% of the annual covered payroll.

The System is administered by the Retirement Board of the City of Battle Creek, Michigan Police and Fire Retirement System. Plan benefit provisions were established and may be amended under the authority of City Ordinances. Contribution requirements were established and may be amended subject to collective bargaining agreements and approval by the Retirement Board and City of Battle Creek City Commission.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The System's financial statements are prepared on the accrual basis of accounting. Member contributions are recognized in the period in which they are due. The City's contributions are recognized when due and the employer has made a formal commitment to provide them. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

CITY OF BATTLE CREEK, MICHIGAN

POLICE AND FIRE RETIREMENT SYSTEM

Notes to Financial Statements

Valuation of Investments and Income Recognition

The System's investments are stated at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages, if any, are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. The fair value of real estate investments, if any, is based on independent appraisals. Investments that do not have established market values are reported at fair value as determined by the custodian, with the assistance of a valuation service.

Administration

Administrative costs are financed through the System's investment earnings.

3. DEPOSITS, INVESTMENTS AND SECURITIES LENDING

Deposits

The System does not maintain any checking or other demand/time deposit accounts. Amounts reported as cash and cash equivalents in the statement of plan net position is composed entirely of short-term investments in money market accounts.

Investments

The Michigan Public Employees Retirement Systems' Investment Act, Public Act 314 of 1965, as amended, authorizes the System to invest in stocks, government and corporate securities, mortgages, real estate, and various other investment instruments, subject to certain limitations. The Retirement Board has the responsibility and authority to oversee the investment portfolio. Various professional investment managers are contracted to assist in managing the System's assets. All investment decisions are subject to Michigan law and the investment policy established by the Retirement Board.

CITY OF BATTLE CREEK, MICHIGAN

POLICE AND FIRE RETIREMENT SYSTEM

Notes to Financial Statements

The System's investments are held in a bank-administered trust fund. Following is a summary of the System's investments (at fair value as determined by quoted market price) as of June 30, 2013:

U.S. treasuries	\$ 16,106,741
U.S. agencies	10,075,669
Domestic corporate securities	27,104,414
Domestic equities:	
Not on securities loan	22,007,061
On securities loan	1,343,335
American depository receipts	11,667,042
International equities	25,253,035
Real estate investment trusts	238,831
Total investments	\$ 113,796,128

In addition to the above, the System has short-term investments of \$6,859,685 as of June 30, 2013 held entirely in money market funds and reported as cash and cash equivalents.

Custodial Credit Risk. For investments, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The System's investment policy requires that investment securities be held in trust by a third-party institution in the System's name. As such, although uninsured and unregistered, the System's investments are not exposed to custodial credit risk since the securities are held by the counterparty's trust department in the System's name.

Short-term investments in money market funds are not subject to custodial credit risk.

Credit Risk. The System's investment policy provides that its investments in fixed income securities be limited to those rated BBB or better by a nationally recognized statistical rating organization. As of June 30, 2013, the System's investments in securities of U.S. agencies were all rated AAA by Standard & Poor's. The System's investments in corporate securities were rated by Standard & Poor's as follows:

AAA	\$ 1,947,670
AA	5,020,844
A	9,352,242
BBB	8,353,540
BB	267,245
Not rated	2,162,873
	\$ 27,104,414

CITY OF BATTLE CREEK, MICHIGAN

POLICE AND FIRE RETIREMENT SYSTEM

Notes to Financial Statements

Concentration of Credit Risk. The System's investments are not exposed to concentration of credit risk relative to a single issuer (i.e. company or government agency) inasmuch as no holdings equal or exceed 5% or more of total investments. The System's investment policy requires that the securities of any one company or government agency should not exceed 10% of the total fund and no more than 25% of the total fund should be invested in any one industry.

Interest Rate Risk. As of June 30, 2013, maturities of the System's debt securities (none of which were callable) were as follows:

	Fair Value	Investment Maturities (fair value by years)			
		Less Than 1	1-5	6-10	More Than 10
U.S. treasuries	\$ 16,106,741	\$ 675,972	\$ 9,598,217	\$ 3,936,452	\$ 1,896,100
U.S. agencies	10,075,669	-	2,879,822	2,197,559	4,998,288
Domestic corporate securities	27,104,414	2,034,203	10,972,869	7,964,996	6,132,346
Total debt securities	\$ 53,286,824	\$ 2,710,175	\$ 23,450,908	\$ 14,099,007	\$ 13,026,734

The System's investment policy provides that the maximum maturity for any single fixed income security is ten years and that the weighted average portfolio maturity may not exceed eight years. At June 30, 2013, the actual weighted average maturity was ten years.

Foreign Currency Risk. Foreign currency risk is the risk that significant fluctuations in exchange rates may adversely affect the fair value of an investment. The System has various investment holdings in international equities of \$25,253,035 and American depository receipts of \$11,667,042; these holdings are primarily in common and preferred stocks of Canadian (dollars) and European (euros) companies. The System does not have any policies regarding foreign currency risk.

Securities Lending. A contract approved by the System's Board permits the System to lend its securities to broker-dealers and banks (borrowers) for collateral that will be returned for the same securities in the future. The System's custodial bank manages the securities lending program and receives cash as collateral. The collateral securities cannot be pledged or sold by the System unless the borrower defaults. Collateral cash is initially pledged at 100 percent of the fair value of the securities lent, and may not fall below 100 percent during the term of the loan. There are no restrictions on the amount of securities that can be loaned. Securities on loan at year-end are classified in the preceding schedule of custodial credit risk according to the category for the collateral received on the securities lent.

At year-end, the System has no credit risk exposure to borrowers as the amounts the System owes the borrowers exceed the amounts the borrowers owe the System. The contract with the System's custodian requires it to indemnify the System if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the System for income distributions by the securities' issuers while the securities are on loan.

CITY OF BATTLE CREEK, MICHIGAN

POLICE AND FIRE RETIREMENT SYSTEM

Notes to Financial Statements

Also at year-end, through a cash collateral investing program provided by the custodial bank, the System has an obligation to repay \$156,332 of cash collateral that was invested in a Sigma Finance Medium Term Note, which is impaired. Any current or future recoveries from Sigma Finance are not expected.

4. ANNUAL REQUIRED CONTRIBUTION

The City's annual required contribution for the year ended June 30, 2013, was \$3,592,634 for pension benefits and \$512,795 for postemployment healthcare benefits. By agreement, effective July 1, 2007, the System is obligated to pay only \$512,795 annually for retiree healthcare and this amount will be provided annually by a City contribution to the System. The City made these required contributions totaling \$4,105,429 and has no retirement benefit obligation.

Three Year Trend Information (pension only)			
Year Ended	Annual Pension Cost	Percentage Contributed	Net Pension Obligation
6/30/2011	\$ 3,846,195	100%	-
6/30/2012	3,659,617	100%	-
6/30/2013	4,105,429	100%	-

5. FUNDED STATUS AND FUNDING PROGRESS

The funded status of the pension portion of the System as of June 30, 2012, the date of the most recent actuarial valuation, was as follows:

Actuarial accrued liability (AAL)	(1)	\$ 145,540,987	
Actuarial value of assets	(2)	<u>115,083,128</u>	
Unfunded AAL (UAAL)	(3)	<u>30,457,859</u>	(1) - (2)
Funded ratio	(4)	<u>79.1%</u>	(2) / (1)
Covered payroll	(5)	<u>12,269,834</u>	
UAAL as % of covered payroll	(6)	<u>248.2%</u>	(3) / (5)

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment and mortality. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, present multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. For purposes of the schedule of funding progress, the actuarial accrued liability value as shown is determined using the entry age actuarial cost method.

CITY OF BATTLE CREEK, MICHIGAN

POLICE AND FIRE RETIREMENT SYSTEM

Notes to Financial Statements

The accompanying schedule of employer contributions presents trend information about the amounts contributed to the System by the employer in comparison to the ARC (annual required contribution), an amount that is actuarially determined in accordance with the parameters of GASB Statement 25. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Additional information as of the latest actuarial valuation includes:

Valuation date	June 30, 2012
Actuarial cost method	Entry-age
Amortization method	Level percent-of-payroll
Remaining amortization period	30 year open
Asset valuation method	5-year smoothed market w/ 20% corridor
Actuarial assumptions:	
Investment rate of return	7.0%
Projected salary increases	4.5% to 12.9%
Assume rate of payroll growth	4.5%
Cost-of-living adjustments	None
Inflation rate	3.0% to 4.0%

6. RISK MANAGEMENT

The System is exposed to various risks of loss related to torts, errors and omissions. The System participates in the City of Battle Creek's risk management program for all of these exposures. The City's risk management program is primarily a self-insured program with reinsurance for amounts in excess of aggregate loss limits. The City estimates the liability for unpaid claims (including claims incurred but not reported) and allocates the cost to all appropriate entities and funds. There is no further exposure to the System that would require a liability to be recorded in the financial statements.

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REQUIRED SUPPLEMENTARY INFORMATION

**CITY OF BATTLE CREEK, MICHIGAN
POLICE AND FIRE RETIREMENT SYSTEM**

Required Supplementary Information

Schedule of Funding Progress - Pension Only						
Actuarial Valuation Date	Actuarial Value of Assets (A)	Actuarial Accrued Liability (AAL) (B)	(Over) Under Funded AAL (OAAL/UAAL) (B-A)	Funded Ratio (A/B)	Covered Payroll	OAAL/UAAL as a % of Covered Payroll
6/30/2003	\$ 103,655,770	\$ 100,346,606	\$ (3,309,164)	103.3%	\$ 11,855,130	-27.9%
6/30/2004	103,745,735	104,336,169	590,434	99.4%	12,114,360	4.9%
6/30/2005	102,755,663	110,487,311	7,731,648	93.0%	12,085,192	64.0%
6/30/2006	103,283,413	114,501,359	11,217,946	90.2%	12,283,787	91.3%
6/30/2007	108,245,308	121,823,413	13,578,105	88.9%	12,358,265	109.9%
6/30/2008	113,285,618	126,752,205	13,466,587	89.4%	12,497,433	107.8%
6/30/2009	112,094,168	133,052,817	20,958,649	84.2%	11,953,735	175.3%
6/30/2010	112,804,385	137,557,259	24,752,874	82.0%	12,383,339	199.9%
6/30/2011	115,774,764	140,863,694	25,088,930	82.2%	12,609,794	199.0%
6/30/2012	115,083,128	145,540,987	30,457,859	79.1%	12,269,834	248.2%

Schedule of Employer Contributions - Pension Only

Year Ended June 30	Annual Required Contributions	Percentage Contributed
2004	\$ 1,268,053	100%
2005	1,824,879	100%
2006	2,458,298	100%
2007	2,877,942	100%
2008	3,117,333	100%
2009	3,408,722	100%
2010	3,122,270	100%
2011	3,846,195	100%
2012	3,659,617	100%
2013	4,105,429	100%